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E.O. 12958: N/A  
TAGS: [ECON](#) [ETRD](#) [EINV](#) [EAGR](#) [EFIN](#) [BR](#)  
SUBJECT: Brazil: Scenesetter - Economic Partnership Dialogue December 14

SENSITIVE BUT UNCLASSIFIED

1.(SBU) SUMMARY: The fourth meeting of the Economic Partnership Dialogue (EPD) provides an excellent opportunity to reinforce the importance the USG attaches to deepening and expanding the positive economic agenda between the United States and Brazil. This meeting will permit the two sides to cement a broader partnership under the Dialogue created to launch new economic cooperation opportunities between State and the Ministry of External Relations (MRE) and to provide impetus and support to initiatives developed in other channels. Our economic interests in engaging with Brazil are bilateral, including increasing trade and investment opportunities through addressing regulatory barriers and liberalizing civil aviation; regional, including promoting labor standards; and global, including development cooperation as well as engagement in fora including G20 and the WTO. The December 14 meeting will further cement our expanding development cooperation partnership in Africa and Haiti and deepen our dialogue on the regulatory and business climate issues that support innovation and competitiveness. This Dialogue is an opportunity to lay out our vision for the U.S.-Brazil economic relationship as Brazil continues to develop as a significant regional and global economic player, potentially laying the foundation for expanded positive cooperation in other policy areas over time. END SUMMARY

## OVERVIEW

2.(SBU) Brazil is a developing country moving onto the global stage. The tenth largest world economy, Brazil has evolved from IMF creditor to donor, from development assistance recipient to provider, and from a country that suffered extreme economic shocks to a country emerging early from the global crisis and confident in its macroeconomic policy. New offshore pre-salt finds could eventually lead to Brazil becoming a significant oil and gas exporter. The Mission continues to seek opportunities to deepen investment and trade ties with Brazil bilaterally in order to increase business opportunities, job growth, and economic development. We are building partnerships with Brazil to promote regional and global economic and social inclusion goals, including addressing the global financial crisis, trade liberalization, and economic development cooperation. We continue to work with Brazil to build consensus for World Trade Organization trade liberalization; to promote enhanced cooperation in fora such as Organization for Economic Cooperation and Development, World Health Organization and International Civil Aviation Organization; and to create the conditions for global development and prosperity. At the same time, we are cooperating with Brazil to address the regulatory, legal and infrastructure challenges that constrain Brazil's growth and social inclusion goals and hurt U.S. exporters

and investors.

3.(SBU) Economic issues are proving to be the pathway to increasingly productive GOB engagement - both because as a large emerging economy it is beginning to have a natural seat at the table and because GOB most easily sees how global economic issues directly impact its own well-being and national security. Constructive engagement in the G20 has given Brazil increased confidence that it can and should engage in issues outside its own borders. Brazil's interest in taking on the leadership mantle economically offers numerous opportunities for engagement, encouraging Brazil to take on increasingly responsible roles globally. It is important to frame approaches to GOB as a partner, and not a junior partner. GOB takes particular pride that, having been through many developing country experiences (previous financial crises, addressing GINI inequalities, infrastructure impact on growth, etc), it is uniquely placed to help developing countries tackle their own challenges, drawing on Brazilian "lessons learned." GOB has been receptive to partnering with us on development cooperation, including a newly developing initiative in Mozambique and Haiti on agriculture, health and infrastructure development. Cooperation on political and security issues remains more difficult to navigate, where GOB is less persuaded that playing an active role on issues beyond its borders has implications for its own domestic and global security and tends sometimes to stress a "no judgment" approach on many issues that reflect in part its own sovereignty sensitivities. This, too, is evolving, though more slowly than on the economic side.

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3.(SBU) Brazil is a country where personal relationships matter a great deal. President Lula and POTUS' positive interactions have translated into tangible follow-on action, such as Finance Minister Mantega's (not previously notable for an eagerness to engage the United States) recent travel to the United States to meet Treasury Secretary Geithner and urge resumption of a bilateral MOF/Treasury dialogue. MRE contacts have stressed that FM Amorim is personally committed to the success of the EPD. MRE is delighted that U/S Hormats will lead the Dialogue on the United States side. The Brazilian chair, Undersecretary for Economic Affairs Pedro Mendonca, is an experienced diplomat responsible for the WTO negotiations and is Brazil's G20 Sherpa.

#### POLITICAL CONTEXT

4.(SBU) The Brazilian political elite and media are already focused on the October 2010 national elections for president, governors of all 26 states and the federal district, two-thirds of the senate, and all federal deputies. Ministers who intend to run for any of these offices must, under Brazilian law, resign by April 2010 (six months before elections), and some will leave in March or earlier. Although many Ministers are expected to leave, FM Amorim is expected to remain in place for the duration of the Lula Administration. Lula is constitutionally barred from seeking a third term and has supported Civil Household Minister (Prime Minister-equivalent) Dilma Rousseff as his party's candidate. Rousseff is currently a distant second in the polls to likely opposition candidate Sao Paulo Governor Jose Serra, but the race remains unpredictable this early in the process.

5.(SBU) The United States and Brazil share the basic goals of fostering hemispheric stability and integration, promoting democracy and human rights, and preventing transnational illicit activity. The attainment of a permanent seat on the UN Security Council has been a central goal of Brazil's foreign policy under President Lula's government. Regionally, Lula has maintained Brazil's historic focus on stability, seeing good relations with all parties as the best way to achieve this goal. As a result,

Brazil maintains an active dialogue with Venezuela and Cuba, has worked to foster good relations with Bolivia and Ecuador, and has stood firmly on the principle of respect for sovereignty in the region. In line with Lula's demonstrated interest in Brazil playing a larger role in global issues, as well as expanding Brazil's commercial ties, Lula hosted separate visits from Iranian President Ahmadinejad, Israeli President Peres, and Palestinian President Abbas, among others, in November.

#### ECONOMIC CONTEXT

6.(SBU) Brazil's annual Gross Domestic Product (GDP) grew 5.1 percent in 2008, and inflation was 5.8 percent. The global economic crisis eroded previous predictions for annual GDP growth for 2009 from four per cent to essentially flat or slightly negative. Despite this decline in immediate prospects, Brazil has weathered the crisis better than most major economies and shows signs of a recovery, led by strong domestic demand and a growing middle class. Conservative macroeconomic policies in the years prior to the crisis, and targeted responses during the crisis -- including credit injections in the financial system and tax cuts on automobiles and consumer durables -- played a role in lessening the impact of the global crisis on Brazil. Growth in 2010 is expected to return to approximately 5%. That said, Brazil's growth potential is constrained by factors including its tax code (2600 hours/year to pay taxes), its rigid labor law, and its obtuse licensing procedures (126 days to start a business). Brazil ranks 129 on the World Bank's Ease of Doing Business list.

7.(SBU) Brazil is a major producer and exporter. Agriculture makes up 36 percent of exports, and the agribusiness sector accounts for 25 percent of Brazil's GDP. Brazil is a leading exporter of

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soybeans, beef, sugar, coffee, and orange juice. Brazil also distinguishes itself as a major exporter of civilian aircraft, steel, and petrochemicals. The United States is Brazil's top trading partner overall, although in March China became Brazil's primary export destination. Prior to the current financial crisis, U.S.-Brazil trade experienced significant annual growth, surpassing USD 60 billion in 2008. Brazil typically experiences a slight positive balance in the trade relationship. However, in the first three quarters of 2009, Brazilian exports to the United States totaled USD 11.4 billion, while imports from the United States totaled USD 14.8 billion, resulting in a slightly negative trade balance.

8.(SBU) In recent years, U.S. Foreign Direct Investment (FDI) in Brazil has averaged around USD 4 billion per year. In the second quarter of 2009 (the most recent available data), the Bureau of Economic Analysis reported U.S. FDI into Brazil of USD 1.2 billion. The Economist noted recently that FDI into Brazil from all sources increased 30% last year, while overall FDI worldwide contracted 14%. At the same time, Brazil has significant offensive investment interests. Illustrating a trend of increasing external investment, Brazilian Central Bank figures show that the stock of Brazilian FDI in the United States increased from USD 3.9 billion in 2006 to USD 6.025 billion in 2007 (the last year for which figures are available). Brazil holds investment grade status from the major rating entities.

#### ANNOTATED EPD AGENDA TOPICS

9.(SBU) The topics below follow the order of the EPD agenda:

**CIVIL AVIATION:** The EPD will welcome the continued implementation of the June 2008 civair agreement. You may wish to note our hope that expanded flight possibilities into the north/northeast of Brazil will further social inclusion objectives, as potential increased American tourism and other business opportunities could also benefit development objectives in that region. We are exploring with ANAC whether further liberalization in air cargo is possible in the near term and can welcome MRE confirmation that the civair authority, ANAC, is prepared to meet again in 2010 to discuss Open Skies possibilities.

**COMPETITIVENESS:** The last EPD session agreed the Joint Commission on Science and Technology (JCM) would discuss innovation and report to the EPD. The November 19-20 JCM in Washington discussed United States' and Brazil's efforts to promote innovation and means of governmental cooperation. Members of the U.S. Delegation pointed to the importance of certain institutional features, including an effective intellectual property rights regime and a tradition of venture and "angel" investing to foster innovation and therefore competitiveness. They recognized that not all countries will or should follow the same innovation model as the United States, but underlined the importance of the government 'not getting in the way' of private sector innovation. Commerce Department representatives noted the creation of the Office of Innovation and Entrepreneurship and the National Advisory Council on Innovation and Entrepreneurship, designed to bring a whole of government approach to fostering innovation. The Brazilian Delegation pointed out that Brazil is still a developing nation and therefore has a different perspective than developed nations on a variety of topics related to innovation. These include differences in opinion about the role of intellectual property rights and a strong view that the government must play an active role, e.g., through providing incentives, in fostering innovation. Despite these differences, the Brazilian Delegation was very interested in working with the USG to find ways to better foster innovation in Brazil. Possible next steps include a workshop to identify common areas of interest, a workshop or white paper to begin tackling the idea of how to benchmark public-private partnerships and public sector innovation incentives, and a workshop to identify new models of cooperation; to include financial, political and other aspects to support innovation and competitiveness. On-going efforts under the DOC-MDIC (Trade Ministry) Commercial Dialogue include cooperation on venture capital.

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**OECD:** MRE has indicated that the OECD Secretariat has suggested increased Brazilian participation in OECD labor and health under Brazil's Enhanced Engagement program. MRE is interested in hearing our experiences working in these areas with the OECD, from how effective and useful we have found the OECD role in these topics to how the USG organizes to cover these committees. The discussion provides an opportunity to continue to encourage GOB movement toward eventual OECD membership.

**AGRICULTURE:** MRE understands that USDA has the lead in USG on CODEX and on the Consultative Committee on Agriculture (CCA). Regardless, the Brazilians wish to emphasize again their concerns regarding developing country participation in CODEX and to press State to urge a meeting in the near term for the USDA-Ministry of Agriculture (MAPA) CCA. A technical level meeting rather than a CCA may be the appropriate next engagement on the issues MAPA wishes to discuss.

**REGULATORY DIALOGUE:** MRE has expressed a new interest in supporting and fostering further regulator to regulator cooperation and exchange. Regulatory reform is critical to improving the business climate in Brazil for U.S. exporters and investors. MRE

support could be helpful in encouraging Brazilian regulatory agencies to engage further, and MRE buy-in ensures regulator to regulator initiatives come to fruition. Current cooperation, at differing levels of engagement, includes FCC/ANATEL, FAA/ANAC, TSA/ANAC, NIST/INMETRO, FED/CADE, FDA/ANVISA and FERC/ANEEL (details e-mailed to WHA and EEB). Deeper and broader cooperation could, for example, help address TBT and SPS barriers, make progress toward mutual recognition agreements, and expand bilateral cooperation on regulatory issues in third countries.

**TRADE FACILITATION:** Already an active area of cooperation, GOB and Brazilian industry have provided significant feedback that intensified cooperation on trade facilitation would be welcome. USDOC and CAMEX have sponsored two week-long trips this year for GOB agencies to learn how customs clearance and inter-agency coordination works in the United States. Other activities include seminars held by CBP in Brazil for Brazilian Customs and the Federal Police, and a Commercial Dialogue Trade Facilitation meeting held in Manaus in November 2009. The CEO Forum has also prioritized trade facilitation. There is some sensitivity regarding the CBP Trade Facilitation and Supply Chain Security Program within MRE. While CAMEX, MDIC and the trade promotion department within MRE support and welcome the program, the MRE transnational crimes office is not familiar with the program and has been less inclined to support. MRE will benefit from the EPD briefing explaining the advantages to Brazil in participating. MRE also requested to add this topic to the December 9 U.S.-Brazil Bilateral Consultative Mechanism with USTR in Brasilia.

**SECTORAL DIALOGUE:** MRE intends to propose a sectoral event on aeronautics (including parts and services) and ask for USG support for this Brazilian-United States industry event.

**TELECOMMUNICATIONS:** We understand that in addition to resource concerns involved in negotiating a highly technical Mutual Recognition Agreement (MRA), GOB may be reluctant to negotiate on product categories where domestic production exists or where Brazilian labs currently have certification capacity. MRE is likely to propose an extremely limited MRA model covering only products not produced domestically and where no certification capability exists domestically. A MRA would facilitate bilateral exports and provide a model for Latin America as a whole. Brazil will raise internet governance to urge further internationalization.

**DISTINCTIVE PRODUCTS:** GOB has indicated that it will move its rule-making on whiskey/bourbon forward when USG moves the cachaca rule-making forward. MRE put this topic on the first EPD agenda and continues to raise the issue.

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**DEVELOPMENT COOPERATION:** The U.S. and Brazil development cooperation in 3rd countries has been a positive story. MRE's Brazilian Cooperation Agency (ABC) head Farani has been an active partner, traveling to the United States and Mozambique with USG officials to foster and develop that cooperation. USAID and ABC have negotiated an MOU which outlines our continued desire for development cooperation in 3rd countries. Brazil would like to discuss the timing of when to sign this MOU. The U.S. and Brazil are working on two joint projects in Mozambique: 1) agriculture and 2) HIV\AIDS. The U.S. and Brazil led a joint mission to Mozambique in June 2009 and in August 2009, a Brazilian delegation from ABC and Embrapa traveled to Washington to advance discussions on the agriculture project designed to develop an agricultural research platform in Mozambique. In April 2009, at the invitation of USAID, a delegation from the Brazilian Ministry of Health (MOH) visited Mozambique to become familiar with the USAID/Mozambique HIV/AIDS portfolio and to identify ways to strengthen the Mozambican

response to the HIV/AIDS epidemic through trilateral cooperation. A Mozambican delegation visited Brazil from June 29 to July 2, 2009 to become familiar with the Brazilian response to the HIV/AIDS epidemic and to define the principles that will guide further trilateral cooperation among the three countries. Four areas for trilateral cooperation have been identified: improving the visibility, advocacy, and leadership of persons living with AIDS; improving communication strategies; improving Supply Chain Management; and institutionalizing monitoring and evaluation systems. Project documents for both the agriculture and HIV/AIDS trilateral cooperation are expected to be finalized in time for implementation to start January 2010. In addition, CDC is working with the Brazilian Ministry of Health on a program to build epidemiological capacity in Mozambique. ABC and USAID are also working with Sao Tome and Principe on a program to support malaria control activities, focusing support in three primary areas: 1) capacity building, 2) strengthening malaria surveillance and 3) strengthening communications and behavior change. The Oswaldo Cruz Institute, Brazil's premier medical research facility and the headquarters of their National School of Public Health, is in the very initial phases of exploring a partnership with State, NIH, CDC, and other USG partners to develop a National Public Health Institute in El Salvador. Trilateral development cooperation is a win-win in encouraging broader GOB commitment as a donor, deepening our engagement with Brazil bilaterally, and benefiting recipient developing countries.

HAITI: USAID/Brazil and ABC visited Port-au-Prince November 22-26 to identify opportunities for trilateral cooperation in Haiti. Areas identified for potential cooperation include joint technical assistance to train garment sector workers; a jobs program that would promote recycling and advance Haiti's alternative energy development opportunities; bringing Brazilian artist and musician Carlinhos Brown and Haitian musician Wyclef Jean together to collaborate with Brazil and the United States on a cultural/community center that would serve as a driver for community development; an infrastructure project bringing USSOUTHCOM/ USACE and MINUSTAH engineers together to improve roads, including reconstructing the approach roads to the USAID funded Ennery bridge project between Gonaives and Cap Haitien and the creation/improvement of a number of rural farm-to-market roads. USSOUTHCOM also expressed interest in conducting any environmental assessments that may be necessary for the 4C dam project in Artibonite and in working with the Brazilians to do joint assessments of existing power plants in the country to identify ways to increase capacity. The joint USAID/Brazil-ABC trip to Haiti continues the close working relationship that has developed between the two organizations and is a first step towards jointly undertaking projects with a significant development impact in Haiti. MRE will also raise Brazilian access to the HOPE program. MRE must consult with Mercosul partners and pass legislation in order to provide reciprocal HOPE access. MRE has indicated that MERCOSUL partners, particularly Paraguay, have raised objections. No legislation has been forwarded to the Brazilian congress for formal consideration.

"DECENT LABOR": MRE has proposed expanding cooperation in Latin America on "decent labor," possibly with a focus on child and/or forced labor. While some cooperation in this area already exists, MRE is interested in exploring the possibility of further joint work in the region. We are encouraged that Brazil is reaching out

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to deepen regional cooperation on a specific initiative.

FURTHER FOOD SECURITY COOPERATION IDEAS: On November 13, FM Amorim responded to Secretary Clinton's letter on this issue. MRE will be receptive to further ideas offered at the EPD.

**INVESTMENT:** The USG and the Brazilian government have had productive consultations on Bilateral Investment Treaty (BIT) elements on the margins of previous EPDS, although Brazil is still cautious about negotiating BITs given historical congressional opposition. The Brazilian Coalition of Industries (CNI) has traditionally been non-supportive of BITs, seeing them as a constraint on industrial policy, but has recently begun re-examining this position as Brazilian companies' overseas FDI increases. A side session on the margins of the December 14 EPD will further discuss investment agreement elements, with MRE interest particularly in CFIUS and indirect expropriation. GOB has previously indicated a preference to start investment agreement negotiations with a smaller country in the region rather than tackle the topic with USG, and Mission has heard informally that MRE has begun an investment agreement conversation with Chile. The EPD discussion provides an opportunity for forward momentum toward an eventual BIT with the United States.

**TAX:** Progress toward a Bilateral Tax Treaty has been slow. Issues including OECD-standard transfer pricing and the information exchange requirements under a BTT remain difficult to bridge. GOB also fears revenue losses under a potential BTT. Meanwhile the more limited 2007 United States-Brazil Tax Information Exchange Agreement (TIEA) continues to move slowly through the ratification process in the Brazilian Congress. Eventual ratification is expected.

**TRADE:** While trade cooperation is not on the EPD agenda, the December 9 Bilateral Consultative Mechanism between USTR and MRE will explore this topic in depth. GOB has been keen to conclude Doha, and has carefully balanced protectionist instincts on the NAMA side with offensive agricultural interests. The Brazilian private sector has generally acknowledged Amorim did a fairly good job in balancing these interests and resists giving more on the NAMA side (e.g., sectoral agreements). Amorim is increasingly characterizing the fate of Doha as being in U.S. hands. At the same time, GOB is expressing interest in exploring what we can do together bilaterally on trade cooperation. While tariffs must be negotiated in 4+1 (Mercosul plus United States) format, other areas could be discussed bilaterally, with a possibility to build out to 4+1 cooperation if mutual interest exists. The cotton case rankles, and Amorim has talked tough in the press, but MRE (and MDIC) are well aware the issue is not black and white - GOB wants to see USG comply with the ruling, but is aware of the effect on the investment climate of further signaling a lack of commitment to IPR protection.

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